



DRAFT 2007-SVz-22: Procedure for Tax Class Actions

BILL ANALYSIS

Committee:	Revenue Laws Study Committee	Date:	April 30, 2008
Introduced by:		Summary by:	Trina Griffin
Version:	Draft Proposal		Committee Counsel

SUMMARY: *This proposal establishes a procedure for taxpayers seeking to join a class action in order to obtain a refund of an unconstitutional tax.*

BILL ANALYSIS: This proposal does not change the current law with regard to a taxpayer who wishes to commence a class action challenging the constitutionality of a tax. That taxpayer must exhaust the administrative review procedures prior to filing suit. This proposal sets out the procedure for a taxpayer seeking to become a member of a class action once that lawsuit has already been filed. In order to join a class action, a taxpayer would be required to do the following:

- File a claim for refund with the Department of Revenue.
- Include a statement indicating that the sole basis for the claim for refund is the unconstitutionality of a statute and not the application of a statute.
- Specify the pending class action to which the taxpayer seeks to become a member.

These taxpayers would not be required to exhaust the administrative and judicial review process. Once a taxpayer has filed a claim for refund seeking to join a class, the Department would be required to notify the court in which the class action is pending by sending it a copy of the claim for refund.

If a taxpayer's claim for refund includes a basis other than the facial unconstitutionality of a statute, then the taxpayer must file a separate claim for refund.

The statute of limitations for filing a claim for refund is tolled for any taxpayer who, at the time the class action was commenced, could have filed a timely claim for refund. The statute of limitations resumes running upon any of the following:

1. The entry of an order eliminating the taxpayer from the class.
2. The entry of an order denying certification of the class.
3. The dismissal of the action without an adjudication on the merits.
4. The entry of a final judgment

EFFECTIVE DATE: This act is effective when it becomes law and applies to actions filed on or after that date.

CURRENT LAW & BACKGROUND: The current law regarding tax class actions is a complex amalgamation of conflicting common law legal principles, statutes, and judicial interpretation. The intersection of these principles and laws provide little guidance to the Department, taxpayers, or practitioners as to the proper procedure for seeking the refund of an unconstitutional tax.

Prior to the enactment of SB 242 in 2007, the "protest statute" was the relevant statute for class action purposes. For over 80 years, it provided the authority for and the procedural mechanism by which taxpayers could bring a lawsuit challenging the illegality of a tax. This statute required a taxpayer to pay the tax first, file a claim for a refund, and wait 90 days before filing suit. This statute was repealed

by SB 242. However, it is still relevant to understanding the current law because it is the centerpiece of State judicial opinions in this area.

Until 1998, the law in North Carolina was well-settled with regard to the protest rule. North Carolina courts had consistently upheld the application of the statute as a procedural bar to relief if the requirements had not been met. In the Bailey I case, a group of State and local employees filed suit alleging impairment of contract as the result of legislative changes made to the taxation of retiree income. None of the plaintiffs had filed a protest. The North Carolina Supreme Court upheld the dismissal of the case for failure to comply with the procedural requirements of G.S. 105-267. The Swanson case involved a similar issue. In that case, the plaintiffs filed a "class demand letter" attempting to have one claim for refund stand for all claims. The North Carolina Supreme Court also upheld the dismissal of the case.

After the decision in Bailey I, the plaintiffs refiled their case and, this time, all of the plaintiffs had individually complied with the protest requirement. The Court reversed itself. In Bailey II, the Court found that not only were the plaintiffs who had filed a protest entitled to a refund, but all nonprotesters were entitled to a refund as well. The Court seemed most persuaded by the fact that the State had sufficient notice of its liability where there was an identifiable class of affected taxpayers consisting of all those State and local employees who had vested in the State retirement system as of August 12, 1989.

The Smith case was another class action lawsuit comprised of both protesters and nonprotesters challenging the intangibles tax. In that case, the North Carolina Supreme Court also held that the nonprotesters were entitled to relief as well as the protesters. However, the Court based its reasoning, not on the protest statute, but on the uniformity provision of the State Constitution.

Dunn is an ongoing case that has to do with the taxation of interest earned on out-of-state municipal bonds. In December of 2007, the North Carolina Supreme Court upheld the certification of a class that includes plaintiffs who have not filed a refund claim, who are of a different tax type than the named plaintiffs, and for tax years other than the years the plaintiffs are seeking a refund.

In the tax class actions that have been decided since 1998, the North Carolina courts have demonstrated a willingness to effectively allow the claim or protest of one taxpayer stand for the claims of all similarly situated taxpayers despite the protest statute's requirement taxpayers must file a claim for refund as a prerequisite to becoming a party to a lawsuit challenging the legality of a tax.

With the passage of SB 242, the protest statute is repealed and a new statute is enacted setting out the conditions that must be met in order to file a lawsuit challenging the constitutionality of a tax statute, which includes obtaining a final determination from the Department and filing a contested case with the Office of Administrative Hearings. SB 242 did not make any express class action provision.

Given SB 242's silence and the trend over the last 10 years in our courts on this issue, this proposal is designed to provide clear guidance to the Department, taxpayers, and practitioners, consistent with the original intent of the protest statute, that each taxpayer seeking to become a member of a class action must file a claim for refund indicating that desire and identifying the specific class action.